



INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

PROJECT BRIEF AND OUTLINE

1. Subject—Entity Combinations

- 1.1 This project will create requirements and guidance on accounting for entity combinations.
- 1.2 The IPSASB initially approved the Project Brief for the Entity Combinations project in March 2007. In developing the revised Project Brief, the IPSASB considered whether the project should be an IFRS convergence project. However, the IPSASB is of the view that a wider notion of entity combinations is required for the public sector than that reflected in the IASB International Financial Reporting Standard (IFRS) 3, “Business Combinations.” This is because IFRS 3 is specifically aimed at combinations of for-profit private sector business entities. Public sector entities primarily undertake activities to provide goods and services to the community, rather than for a commercial return. Consequently, business combinations as reflected in IFRS 3, do not embrace the full range (and arguably the most frequent types) of entity combinations that occur in the public sector. Therefore, this project is not an IFRS convergence project.
- 1.3 Because this project addresses the wider notion of bringing together separate entities into one reporting entity, the working definition encompasses, but is not limited to, the obtaining of control. The working definition of an entity combination is:

“The bringing together of separate entities and/or operations into one entity.”

- 1.4 This working definition means that the following types of entity combinations will be included in the scope of the project:
 - 1.4.1 An existing or newly established entity gaining control of one or more entities;
 - 1.4.2 An existing or newly established entity gaining control of the operations of another entity or entities; or
 - 1.4.3 Two or more entities combining.

2. Project Rationale and Objectives

- 2.1 Entity combinations are prevalent in the public sector as governments and public sector entities seek to increase the efficiency and effectiveness of the services they provide or for other policy objectives. They can take many forms in addition to the type of entity combination described in IFRS 3.

- 2.2 Currently, limited guidance exists on how to account for the broad range of entity combinations encompassed within this project.

International Guidance on this Topic

- 2.3 IFRS 3 provides guidance on business combinations for business entities in the for-profit private sector where an acquirer gains control of an acquiree. It excludes from its scope combinations of businesses under common control.

National Guidance on this Topic

- 2.4 Many National Standards Setters (NSS) have guidance on transactions or other events in which there is a combination of two or more business entities. However, it appears that few, if any, NSS have in place authoritative requirements that deal with the full range of entity combinations that may occur in the public sector. The project development will include identification and consideration of authoritative guidance in IPSASB Member's and other jurisdictions, as appropriate.

(a) Issues Identified

- 2.5 One of the issues that the IPSASB has already examined is whether entity combinations can be separated between exchange and non-exchange transactions. After extensive debate, the IPSASB agreed that this distinction cannot be clearly articulated and therefore should not be used. Set out below are a number of issues that will need to be considered in progressing this project:
- 2.5.1 Does the working definition of an entity combination encompass all the types of entity combinations intended by the IPSASB and therefore does it establish the intended scope of the project?
- 2.5.2 What is the appropriate accounting treatment for each type of entity combination on initial recognition, including:
- (a) What is the appropriate measurement basis for each type of entity combination?
 - (b) What is the appropriate accounting treatment of the difference arising from the net assets received or net liabilities assumed and the consideration transferred (if any)?
 - (c) Whether the absence of an "owner", as that term is used for financial reporting purposes by business entities, will have an effect on the accounting treatment of certain types of entity combinations in the public sector.
- 2.5.3 What is the appropriate presentation and disclosure for the parties involved in each type of entity combination?
- (a) Should pro forma comparative financial information be permitted and/or required?

(b) Objectives to be achieved

- 2.6 The ultimate objective of the project is to develop a comprehensive IPSAS (or IPSASs) that specifies requirements for financial reporting for each type of entity combination in the public sector.
- 2.7 The intermediate objective is to produce a Consultation Paper. The Consultation Paper will address possible accounting treatments for the types of entity combinations listed in paragraph 1.4 above.

(c) Link to IFAC and IPSASB Strategic Plans

i. Link to IPSASB Strategy

- 2.8 This project was identified in the IPSASB Strategy and Operational Plan 2007–2009, as being a priority because the IPSASB does not currently have any guidance on this topic. The project initially split entity combinations between exchange and non-exchange entity combinations so that a limited convergence project with IFRS 3, “Business Combinations” could be undertaken. However, at its April 2010 meeting, the Board considered that this distinction cannot be clearly articulated and so agreed to reconsider all types of entity combinations at the same time.
- 2.9 In the draft IPSASB Strategy and Operational Plan 2010–2012, the strategic areas of focus include the need to address public sector critical projects. Entity combinations are an important aspect of public sector arrangements.

ii. Link to IFAC Strategic Plan

- 2.10 Issuing International Public Sector Accounting Standards (IPSAS) is a primary role of the IPSASB. The development of accounting guidance on entity combinations supports IFAC’s mission of serving the public interest by contributing to its Strategic Theme of “Recognition as the International Standard Setter” for governmental financial reporting.

3. Outline of the Project

(a) Project Scope

- 3.1 The scope of this project is to determine the appropriate accounting treatment of each type of entity combination in the consolidated and separate financial statements of the entity which acquires or otherwise gains control of an entity and/or operation or the entity resulting from the combining of entities. It includes entity combinations undertaken with or without the transfer of consideration, including entity combinations under common control and entity combinations not under common control, as follows.
- 3.1.1 Combinations of entities, operations, districts or regions. Terms used to refer to these types of combinations, in some jurisdictions, include amalgamations or mergers;

- 3.1.2 Changes in the structure of public sector entities or operations, either within an economic entity or between economic entities. These changes encompass, for example, creation of new departments and transfer of operations between departments. In some jurisdictions, these types of combinations are referred to as reorganizations, restructures, reconstructions, realignments or administrative arrangements;
- 3.1.3 Acquisition of entities or operations on a commercial basis; and
- 3.1.4 Acquisition of entities or operations on a non-commercial basis.
- 3.2 The scope of this project does not include:
 - 3.2.1 The formation of a joint venture; and
 - 3.2.2 The transfer of an asset, a group of assets, a liability or a group of liabilities that do not constitute an entity or an operation.

(b) Major Problems and Key Issues that Should be Addressed

Key Issue #1—Does the working definition of an entity combination encompass all the types of entity combinations intended by the IPSASB and therefore does it establish the intended scope of the project?

- 3.3 A key issue will be to determine whether the working definition of an entity combination encompasses all the types of entity combinations intended by the IPSASB and therefore whether it establishes the intended scope of the project. In agreeing the definition of an entity combination it will also be necessary to establish definitions and explain the terminology used, such as the meaning of “common control.”

Key Issue #2—What is the appropriate accounting treatment for each type of entity combination on initial recognition?

- 3.4 A key issue will be to determine the appropriate accounting treatment in the recipient’s or acquirer’s consolidated financial statements for each type of entity combination. The recipient or acquirer could recognize assets and liabilities currently recognized in the financial statements of the transferee or acquiree. Or the recipient or acquirer could recognize all assets received and liabilities assumed in the transfer, i.e., the recipient or acquirer may recognize some assets and liabilities that the transferee or acquiree had not previously recognized as assets and liabilities in its financial statements. For example, the recognition of an intangible asset that the transferee or acquiree did not recognize as an asset in its financial statements because it developed it internally. Additionally, the appropriate accounting treatment in the recipient’s or acquirer’s separate financial statements will need to be determined.

Key Issue #2(a)—What is the appropriate measurement basis for each type of entity combination?

- 3.5 A key issue will be to determine the measurement basis for the assets received and liabilities assumed, e.g., at carrying amount or at fair value. The recipient or

acquirer could measure the assets received and liabilities assumed from the transferee or acquiree at fair value. Alternatively, the combination could be a trigger to recognize the fair value of all the assets and liabilities in the economic entity or group, so called “fresh start” accounting.

Key Issue #2(b)—What is the appropriate accounting treatment of the difference arising from the net assets received or net liabilities assumed and the consideration transferred (if any)?

- 3.6 A key issue will be to determine the accounting treatment of the difference arising from the net assets received or net liabilities assumed and the consideration transferred (if any). For example, where the recipient entity receives net assets or assumes net liabilities, then the balancing entry could be either a contribution from an owner or a distribution to an owner (only in entity combinations where an owner can be identified), or revenue or expense (directly into the statement of financial performance or directly to net assets/equity or a combination of both).

Key Issue #2(c)—Whether the absence of an “owner,” as that term is used for financial reporting purposes by business entities, will have an effect on the accounting treatment of certain types of entity combinations in the public sector?

- 3.7 A key issue will be to determine whether the owners of the entities involved in the combination can be identified and whether, as is likely to often be the case, the absence of an owner, as that term is used for financial reporting purposes by business entities, has an effect on the accounting treatment of certain types of entity combination.

Key Issue #3—What is the appropriate presentation and disclosure for each type of entity combination?

- 3.8 A key issue will be to determine if the current presentation requirements in IPSAS 1, “Presentation of Financial Statements” are appropriate or whether they need to be amended. Disclosures specifically relating to each type of entity combination transaction or other event will need to be determined.

Key Issue #3(a)—Should pro forma comparative financial information be permitted and/or required?

- 3.9 A key issue will be to determine whether the recipient’s or acquirer’s consolidated and separate financial statements should also include pro forma information as if the acquired entity had been acquired as at the beginning of the most recent comparative period. For example, where two or more entities combine, the results of the comparative period could be restated to reflect the results of all the combining entities for that period.

4. Describe the Implications for any Specific Persons or Groups

(a) Relationship to IASB

- 4.1 This project will encompass combinations of entities under common control. The IASB has identified an item “Common Control Transactions” on the Research and Other Projects section of its Work Plan. The project’s scope is to explore the definition of common control and the methods of accounting for business combinations under common control—in the acquirer’s consolidated and separate financial statements. The project will also consider the accounting for demergers, such as the spin-off of a subsidiary or business. This project is currently deferred and is unlikely to be placed on the active agenda for some time.

(b) Relationship to Other Standards, Projects in Process or Planned

- 4.2 Dependent upon the output of this project, there may be implications for several IPSASs such as IPSAS 23, “Revenue from Non-exchange Transactions (Taxes and Transfers)” and IPSASs 28–30 on financial instruments. The following identifies some of those IPSASs. As the project develops, potential implications for other IPSASs may also be identified. At this stage (November 2010), there are no IFRIC Interpretations that are relevant to this project. The actions of IFRIC will be monitored as the project develops.

Consequential Amendments

- 4.3 The following IPSASs are likely to be directly affected by this project and may require amendment as a consequence – to be monitored as the project develops.

i. IPSAS 21, “Impairment of Non-Cash-Generating Assets”

- 4.4 IPSAS 21, “Impairment of Non-Cash-Generating Assets” is adapted from IAS 36, “Impairment of Assets.” Involvement in an entity combination may need to be identified as a trigger for an impairment test where the measurement of the net assets received and net liabilities assumed are at carrying amount.

ii. IPSAS 26, “Impairment of Cash-Generating Assets”

- 4.5 IPSAS 26, “Impairment of Cash-Generating Assets” does not include goodwill or cash-generating units in its scope. This Standard is also adapted from IAS 36. IAS 36 includes extensive requirements and guidance on the impairment of goodwill and cash-generating units. When IPSAS 26 was developed, the IPSASB concluded that goodwill and cash-generating units should not be included in the scope of this Standard until such a time that the IPSASB has a Standard (or Standards) for entity combinations. Consequently, IPSAS 26 will need to be reviewed as part of this project. Furthermore, where the measurement of the assets received and liabilities assumed in an entity combination are at carrying amount, it may be appropriate to consider this circumstance as a potential indicator of impairment.

iii. IPSAS 31, “Intangible Assets”

- 4.6 IPSAS 31, “Intangible Assets” does not include intangible assets or goodwill acquired in a business combination in its scope. This Standard is adapted from IAS 38, “Intangible Assets,” which contains requirements and guidance on the recognition and measurement of these items. When IPSAS 31 was being developed, the IPSASB concluded that intangible assets or goodwill acquired in a business combination should not be included in the scope of this Standard until such a time that the IPSASB has a Standard for entity combinations. Consequently, IPSAS 31 will need to be reviewed as part of this project.

Other IPSASs Not Directly Related to this Project but need to be Monitored

- 4.7 The following IPSASs are unlikely to be directly affected as a consequence of this project. However, there may be some overlap and interaction, and gives an opportunity to process needed and, arguably, related changes – to be monitored as the project develops.

iv. IPSAS 6, “Consolidated and Separate Financial Statements”

- 4.8 IPSAS 6, “Consolidated and Separate Financial Statements” requires that a controlled entity be excluded from the consolidated financial statements where there is evidence that (a) control is intended to be temporary because the controlled entity is acquired and held exclusively with a view to its disposal within twelve months from acquisition and (b) management is actively seeking a buyer.
- 4.9 IPSAS 6 is based upon the December 2003 version of IAS 27, “Consolidated and Separate Financial Statements.” The IASB removed this exemption from IAS 27 with the issue of IFRS 5, “Non-current Assets Held for Sale and Discontinued Operations” in March 2004. It is unclear as to whether or not there is a public sector specific reason for retention of the exemption in IPSAS 6. In addition, the IASB is currently revising IAS 27. It is expected that a revised Standard will be issued in Quarter 4, 2010. The IPSASB’s draft Work Plan for 2010–2012 potentially includes the revision of IPSAS 6 as part of the entity combinations project. The IASB project will need to be monitored for interaction with this project.
- 4.10 IPSAS 6 includes guidance on how to account for controlled entities in the consolidated and separate financial statements of a controlling entity. IPSAS 6 may also require amendment as the decisions made regarding each type of entity combination, i.e., the initial recognition and measurement of a controlled entity in the recipient’s consolidated and separate financial statements, may affect the subsequent accounting of this controlled entity. For example, it may be appropriate to reconsider whether GBEs should continue to be fully consolidated into the economic entity’s consolidated financial statements.

v. *IPSAS 7, “Investments in Associates”*

- 4.11 IPSAS 7, “Investments in Associates” is based upon IAS 28, “Investments in Associates” (2003). IAS 28 has been subsequently amended. This project may be the appropriate timing to revise IPSAS 7, at the same time as IPSAS 6 and IPSAS 8 are being revised. Note that the IPSASB’s draft Work Plan for 2010–2012 potentially includes the revision of IPSAS 7 as part of the entity combinations project.

vi. *IPSAS 8, “Interests in Joint Ventures”*

- 4.12 IPSAS 8, “Interests in Joint Ventures” is based upon IAS 31, “Interests in Joint Ventures.” The IASB is currently revising IAS 31 and it is expected that an amended Standard will be issued in Quarter 4, 2010. It may be appropriate to revise IPSAS 8 at the same time as IPSAS 6 and IPSAS 7, as they both deal with interests in other entities, as part of this project. Note that the IPSASB’s draft Work Plan for 2010–2012 potentially includes the revision of IPSAS 8 as part of the entity combinations project. The IASB project will need to be monitored for interaction with this project.

(c) **Other—Government Finance Statistics**

- 4.13 One aspect of the IPSASB’s strategic theme of undertaking public sector specific projects is to consider convergence with the statistical basis of accounting where appropriate. This project will explore how entity combinations are accounted for under the statistical basis and whether there are opportunities for the accounting treatment to be similar to that used for the statistical basis of accounting. In addition, the project may also consider disclosures to assist users in reconciling differing requirements. This may result in a review of IPSAS 22, “Disclosure of Financial Information about the General Government Sector.”

5. Development Process, Project Timetable and Project Output

(a) **Development Process**

- 5.1 The development of outputs will be subject to the IPSASB’s formal due process. The issuance of documents for public comment will be subject to the usual IPSASB voting rules. As the project progresses, regular assessments will be made to confirm the proposed path in the project timetable remains the most appropriate.

(b) Project timetable

Major Project Milestones	Expected Completion
Present revised Project Brief	November 2010
Discussion of issues and development of a Consultation Paper (CP) (January–September 2011)	
Approve CP (4 month comment period)	September 2011
Review of responses to CP and development of an Exposure Draft or Drafts (February 2012–March 2013)	
Approve ED/EDs (4 month comment period)	March 2013
Review of responses to ED and development of a IPSAS/IPSASs	
Approve Final IPSAS /IPSASs	2014

- 5.2 The review of IPSASs 6–8 will commence when the review of responses to the CP has been completed and will be undertaken in the same time frame as the development of the entity combinations ED/EDs and issue of an IPSAS(s).

(c) Project output

- 5.3 The initial output will be a Consultation Paper. The ultimate output will be an IPSAS or IPSASs.

6. Resources Required

(a) Task Force/Subcommittee

- 6.1 A Task Force may be required to assist in providing a broad spectrum of the types of entity combinations that are undertaken.

(b) Staff

- 6.2 It is envisaged that 0.5 Full Time Equivalent (FTE) will be required to resource the project.

(c) Factors that might add to complexity and length

- 6.3 Factors that might add to the complexity and length of the project include:
- 6.3.1 The wide range of entity combinations undertaken in the public sector.
 - 6.3.2 The relative lack of existing guidance on entity combinations in the public sector.
 - 6.3.3 The interaction between this project and IPSAS 6.
 - 6.3.4 The interaction between this project and the development of the Conceptual Framework.

7. Important Sources of Information that Address the Matter being Proposed

- 7.1 Potential sources of information regarding entity combinations include:
 - 7.1.1 IFRS 3, “Business Combinations.”
 - 7.1.2 The IASB’s currently deferred project on Common Control Transactions.
 - 7.1.3 National Standard Setters guidance on entity combinations.
 - 7.1.4 The Government Finance Statistics Manual (2001).
 - 7.1.5 The System of National Accounts (SNA) 2008.